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Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
Washington, DC 20423-0001

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Public Record

Re: STB Ex Parte No. 575
Review of Rail Access and Competition
Issues – Renewed Petition of the Western
Coal Traffic League

Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are an original and ten copies of "Reply Comments of the Association of American Railroads." Also enclosed is a diskette containing the document in Word format. Please date-stamp the enclosed extra copy and return it to our representative.

Sincerely yours,

Robert M. Jenkins III

RMJ/bs

Enclosures

**BEFORE THE**
**SURFACE TRANSPORTATION BOARD**

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**STB EX PARTE NO. 575**

**REVIEW OF RAIL ACCESS AND COMPETITION ISSUES—RENEWED PETITION OF THE WESTERN COAL TRAFFIC LEAGUE**

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# REPLY COMMENTS OF THE ASSOCIATION OF AMERICAN RAILROADS

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Dated: March 28, 2006

**BEFORE THE**
**SURFACE TRANSPORTATION BOARD**

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**STB EX PARTE NO. 575**

**REVIEW OF RAIL ACCESS AND COMPETITION ISSUES—RENEWED PETITION OF THE WESTERN COAL TRAFFIC LEAGUE**

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**REPLY COMMENTS OF THE ASSOCIATION OF AMERICAN RAILROADS**

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Pursuant to the Board's Decision served February 1, 2006, the Association of American Railroads ("AAR") submits these reply comments concerning the renewed petition of the Western Coal Traffic League ("WCTL") for a rulemaking proceeding to restrict the railroad industry's use of contractual "paper barriers."[1] Regrettably, the length of this reply is necessitated by the diverse range of assertions made by WCTL and its supporters.[2]

## INTRODUCTION AND SUMMARY

The gravamen of WCTL's renewed petition and the opening comments filed by WCTL and other parties asking the Board to start a rulemaking proceeding is that paper barriers should be presumed to be anticompetitive and contrary to the public interest. Their idea is that the Board should not only discourage new long-lived paper barriers but also "reform" existing

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[1] As noted in the AAR's opening comments, the term "paper barrier" evokes misconceptions about what is essentially an interchange commitment between rail carriers. This is not just an issue of semantics. Interchange commitments frequently involve much more than just restrictions on the ability of a shortline carrier to interchange traffic with long-haul carriers other than the one that sold or leased track to the shortline. Some interchange commitments may include joint arrangements whereby the long-haul carrier performs all of the marketing, administrative, and pricing duties associated with through traffic, so that the shortline performs only the physical origination and termination operation. Nevertheless, for ease of reference, but with these caveats in mind, the AAR will continue to use the shorthand term "paper barrier" herein.

[2] Attached is a Glossary containing the abbreviations used herein to refer to the opening comments of the various commenters in this proceeding.

contracts between railroads containing paper barriers. This proposal for substantial regulatory interference with a remarkably successful contractual vehicle for improving the efficiency and economy of through rail service is seriously misguided—both as a matter of law and as a matter of public policy.

Paper barriers are not peripheral contractual requirements that are ancillary to the sale or lease of track by a long-haul carrier to a shortline carrier. Often, they are core requirements without which the transaction would not and could not take place. They enable a "win-win" combination of low price (in some cases, no price) for the sale or lease to the shortline carrier, and the potential for more responsive local and through service, as well as more traffic for the long-haul carrier.

The idea that paper barriers are "restraints of trade" that should be discouraged completely misconceives their purpose. When a long-haul carrier elects to sell or lease track to a shortline with a paper barrier, the long-haul carrier does so in order to improve its business. The shortline proposes to provide the beginning or end of the line-haul. The long-haul carrier and the shortline carrier intend to work together to provide that line-haul service. Neither intends to create a competing long-haul business. A paper barrier is no more a "restraint of trade" in this context than "bridge-only" or "overhead" trackage rights are a restraint of trade. Overhead trackage rights do not permit the trackage rights tenant to compete for the landlord's business on the line, but that was never the parties' intention in the first place. The trackage rights tenant did not contract for the right of access to the shippers on the line, and it would twist the meaning of "restraint of trade" beyond recognition to suggest that overhead trackage rights are anticompetitive because the trackage rights tenant did not contract for more. The situation is just the same when a shortline carrier leases or purchases limited operating rights from a long-haul carrier through the convenient mechanism of a paper barrier.

This is why the Board and its predecessor, the Interstate Commerce Commission ("ICC"), have repeatedly rejected allegations that specific paper barriers involved in specific transactions that have come before the Board and the ICC were or are "anticompetitive." Obviously, shippers on a line are in no worse competitive posture because a long-haul carrier sells or leases another carrier limited rights to operate on a line than if the long-haul carrier had not entered into the transaction at all. And insofar as the shortline is able to provide better originating and terminating service at lower cost, the agency has concluded that these kinds of transactions "promote competition, as well as various other rail transportation policy goals." ICC Finance Docket No. 31089, *Montana Rail Link, Inc.—Exemption Acquisition and Operation—Certain Lines of Burlington Northern Railroad Company* (served May 26, 1988) ("*Montana Rail Link*"), slip op. at 21.

Nothing has changed to alter the STB's and the ICC's consistent position. The reliance that WCTL and others place on the Board's decision in Ex Parte No. 582 (Sub-No. 1), *Major Rail Consolidation Procedures* (served June 11, 2001) ("*Major Rail Consolidation Procedures*"), is completely misplaced. The Board there held that mergers between Class I carriers would likely have anticompetitive effects that could not be mitigated unless the applicants offered offsetting measures to enhance (rather than only maintain) competition. Slip op. at 16-21; 49 C.F.R. § 1180.1. WCTL and the other proponents of a rulemaking here have pointed to no anticompetitive effects of shortline lease or sale transactions that could possibly warrant placing offsetting "competition-enhancing" conditions on such transactions.

On the other hand, as described in the Comments of the Railroad Industry Working Group ("RIWG"), the Railroad Industry Agreement ("RIA") has continued to provide a valuable forum for the Class I railroads and the shortline railroads to address concerns that arise about the day-to-day operation of paper barrier provisions. Emblematic of the success of the RIA is the fact that the American Short Line and Regional Railroad Association ("ASLRRA"), which represents approximately 425 Class II and III railroads, filed comments that extolled the work of the RIWG and the "important and productive role" played by paper barriers in the rail industry. ASLRRA Comments at 3. Like the AAR, the "ASLRRA believes that there is no reason now for the STB to trump the private sector and initiate rulemaking." Id. at 2.

WCTL and some of the other shipper commenters complain that they were not involved in negotiating the RIA and do not take part in the paper barrier interpretation functions of the RIWG. But the RIA covers a wide range of inter-carrier relationships, so it was and is appropriate to limit the negotiation and interpretation of that agreement to the carriers involved. In any event, shippers are not shy about making their views known to the carriers that serve them about their service and their rates, and many requests from shortlines for paper barrier waivers under the RIA are made in order to address shipper requests. Of course, if shippers are still not satisfied with the service or rates they receive, a shipper on a line subject to a paper barrier has the same recourse to regulatory oversight by the Board as a shipper on a line that is not subject to a paper barrier.

The shipper proponents of a rulemaking proceeding, however, want more. They want the Board effectively to "reform" even existing contracts containing paper barriers, so as to convert the shortline railroad's operation from a complementary business arrangement, in connection with the long-haul operation of the Class I railroad that sold or leased trackage to the shortline, into a competitive service that brokers long-haul business between or among Class I railroads. That is a prescription for a regulatory donnybrook. In the first place, the Board and the ICC have long encouraged railroads to engage in exactly the kind of innovative and efficiency-enhancing contractual arrangements that are represented by the hundreds of shortline sales and lease transactions that have taken place since passage of the Staggers Rail Act of 1980. The class exemption under which most of those transactions have been approved is based on the assumption that transactions that do not ***diminish*** competition should be exempted. *Class Exemption for the Acquisition and Operation of Rail Lines Under 49 U.S.C. 10901,* 1 I.C.C.2d 810, 817 (1985) ("*Class Exemption*"), review denied sub nom. *Illinois Commerce Comm. v. ICC,* 817 F.2d 145 (D.C. Cir. 1987) (table). There is no basis for a retroactive rulemaking to effectively revoke the exemption and reopen those transactions on the theory that paper barriers should now be restricted in order to ***enhance*** competition.

In the second place, even assuming the Board had the legal authority to reopen pre-existing transactions, who is going to pay? Although there are a wide variety of paper barriers, most of them involve payment by the shortline (sometimes no payment at all) below the full value of the line absent the commitment. The greater of going concern value or net liquidation value is the constitutional minimum to which the long-haul carrier would be entitled if by regulatory fiat the Board determined that the paper barrier should be removed. Surely, the shortline carriers, who are not here petitioning for paper barriers to be removed, could not be required to pay for "access" they are not seeking. Would the shippers pay? That too is highly unlikely, since their clear purpose here is to use the shortline operation as a lever to obtain lower rates, not to pay the long-haul carrier the value of its property interest. Perhaps it would be left to the Federal government to pay. If no one is willing to pay, would the transaction be unwound entirely and the track returned to the long-haul carrier? What would that accomplish, except the loss of much of the shortline industry and disruption of a multitude of efficient service arrangements?

The simple fact of the matter is that there is no good basis in law or policy for the Board to revisit a quarter century of consistent decisions upholding paper barriers as a valuable contractual tool for railroads to stimulate business and improve the economy and efficiency of their long-haul service. The Board would be ill-advised to begin the rulemaking proceeding requested by WCTL and its supporters.

## ARGUMENT

### I. THERE IS NO LEGAL OR LOGICAL FOUNDATION FOR THE BOARD TO INITIATE A RULEMAKING PROCEEDING TO RESTRICT PAPER BARRIERS

The background of this proceeding and WCTL's rulemaking proposal were described in the Board's February 1, 2006 Decision and need not be repeated here. What ***is*** important to stress is that WCTL and its supporters bear a heavy burden of demonstrating any need for a rulemaking to consider restricting the use of paper barriers. The Board and the ICC have repeatedly considered, and repeatedly rejected, claims that specific paper barriers in specific transactions were "anticompetitive" or otherwise contrary to the national transportation policy, and nothing has changed to alter that sound judgment. None of the "restraint of trade" and other antitrust labels applied to paper barriers has any logical (much less legal) application to them. The RIA provides protections against abuses of paper barriers. Further, shippers have the same regulatory protection against rate and service abuses on lines that are subject to paper barriers that they have on lines that are not. The fact that more than one carrier may be involved, or that a paper barrier may define the contractual relationship between the carriers involved in the service, neither adds to nor detracts from a shipper's ability to obtain relief.

### A. When Presented With Specific Evidence In Individual Transactions, The ICC And The Board Have Consistently Upheld Paper Barriers—And Nothing Has Changed To Warrant A Different Approach Now

The passage of the Staggers Rail Act of 1980 was a watershed event for the rail industry. It precipitated literally hundreds of shortline sale and lease transactions. Many of those transactions involve paper barrier terms that were part of the consideration for the transaction, and often were the only economic basis upon which the transaction could occur. In other words, they are "of the essence" to the transaction. The long-haul carrier would not have entered into the transaction without protection for its long-haul revenues, and the shortline could not have afforded to pay the market value of the line had it included unrestricted interchange rights. Frequently, these agreements provide additional benefits to the shortline, and convenience for the shipper, because the long-haul carrier retains some or all of the marketing, administration, and pricing responsibilities for through service. The shortline is responsible only for the physical operation of the track, and receives a per-car payment from the long-haul carrier for its services in connection with through movements. Shippers also benefit because, as long-haul carriers have enhanced their productivity, they have passed the cost-savings along to both competitive and exclusively-served shippers. See *Rail Rates Continue Multi-Year Decline,* STB Office of Economics, Environmental Analysis, and Administration (Dec. 2000) at 2-3.

After passage of the Staggers Act, the ICC was flooded with individual requests for exemption for shortline sale and lease transactions, which it routinely granted. In 1985, the ICC adopted a class exemption for these transactions, holding that it would "foster the rail transportation policy of 49 U.S.C. 10101a by minimizing the need for Federal regulatory control over the rail transportation system, ensuring the development and continuation of a sound rail transportation system, fostering sound economic conditions in transportation, reducing regulatory barriers to entry and encouraging efficient rail management." *Class Exemption,* 1 I.C.C.2d at 817. The ICC further held that "these transactions will not result in an abuse of market power," because "[p]roposals under this class exemption generally will maintain the *status quo* and will not change the competitive situation." Id.

In 1988, in the *Montana Rail Link* case, the ICC addressed at some length concerns that had been raised about paper barriers under which the long-haul carrier retained certain rate and routing control over the line it leased to the smaller carrier.[3] The ICC first rejected the notion that such a lease or sale transaction must ***increase*** competition in order to avoid revocation of the exemption:

> Petitioners are in error in contending that a transaction cannot qualify for this exemption unless it will actually increase the level of competition existing prior to the sale, or, stated differently for the circumstance here, that BN's competitors must be placed in a better competitive posture (even at BN's expense) than they were in prior to the transfer. [Slip op. at 20.]

The ICC then rejected the idea that the paper barriers involved were "anticompetitive," because they would allegedly reduce competition and increase the long-haul carrier's market power:

> BN's transfer of these lines that it formerly owned and operated to a new, separate, independent carrier will not result in more control or any new power by BN over transportation involving those lines. Under the parties' agreements BN has retained certain rate and routing control over MRL. Prior to the transfer, as owner, BN exercised total control over rates and routes on the southline, including the power to discourage shippers from interlining at various BN-controlled gateways. Consequently, BN's control over this traffic after the transfer, ***even if MRL were totally precluded from offering competitive options to its shippers vis-à-vis the BN***,

[3] The long-haul carrier there also granted "bridge-only" or "overhead" trackage rights to the smaller railroad in some locations to facilitate the transaction. Slip op. at 2.

> would not lead to the conclusion that competition would be reduced. There is no new condition imposed upon the traffic by this transaction that would cause a shipper to pay rates exceeding the levels it would have otherwise faced with the prior, single carrier.
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> * * *
>
> BN's control over MRL interline traffic subject to [paper barrier] charges is no greater, and cannot be greater, than when BN was the sole carrier. It is possible, of course, that BN's control over those gateways may discourage MRL from offering any new routing options to some of its shippers. If so, competition may not be increased, but it will not be reduced either. The evidence supports the railroads' assertion that such charges, as well as the trackage rights grant and other agreement provisions and restrictions, are designed solely to obtain the expected result that BN retains traffic that moved on its system either to or from the subject tracks prior to the transaction. [Id., emphasis added.]

Finally, the ICC concluded that, if anything, the transaction, including the paper barriers, would likely be pro-competitive:

> Rather than being anticompetitive, we conclude that this transaction will likely promote competition, as well as various other rail transportation policy goals. As we have stated in the past, it has been our experience with transactions of this type that the acquiring firm will bring new vitality to the line. Typically, the new operator has closer ties to local communities and will provide better service, often at lower rates, and will work closely with shippers on the line. *See, e.g.,* Finance Docket No. 31094, *Grainbelt Corporation—Acquisition and Operation Exemption—Burlington Northern Railroad Company* (not printed), served September 17, 1987 (*Grainbelt*). [Id. at 21.]

The Board's position has been the same as the ICC's when the Board has had occasion to consider the details of specific paper barriers in a lease or sale transaction. Thus, in STB Finance Docket No. 32766, *Portland & Western Railroad, Inc.—Lease and Operation Exemption—Lines of Burlington Northern Railroad Company* (served October 15, 1997) ("*Portland & Western*"), the Board concluded:

> [T]he circumstances surrounding the transaction indicate that the transaction was motivated by a desire of the lessor and lessee to realize legitimate business goals. . . . The lease provisions do for all practical purposes require PWR to route its traffic over BN. But these provisions do not reduce the level of competition that existed in this market before the lease since BN was free to route the traffic it originates over its own lines. ***The Board and the Interstate Commerce Commission have consistently held that carriers are not obligated to increase the existing level of competition when they undertake sale or lease transactions such as this one.*** *See, e.g.*, [*Montana Rail Link*] and *South Carolina Central Railroad Company, Inc.—Purchase and Lease—CSX Transportation, Inc., Lines in Georgia and Alabama*, Finance Docket No. 31360 (ICC served May 4, 1989) ["*South Carolina*"]. . . . The pre-lease competitive setting essentially has been preserved, not altered. [Slip op. at 5-6, emphasis added.]

In STB Finance Docket No. 34495, *Buckingham Branch Railroad Company—Lease—CSX Transportation, Inc.* (served November 5, 2004) ("*Buckingham*"), the Board considered a challenge to a paper barrier in the context of an application under Section 11323(a)(2). Because the transaction did not involve the merger or control of two or more Class I railroads, it was governed by the approval standard set forth in Section 11324(d), requiring the Board to "approve the application unless the Board finds that (1) as a result of the transaction, there is likely to be substantial lessening of competition, creation of a monopoly, or restraint of trade in freight surface transportation in any region of the United States, and (2) the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs." Slip op. at 6. The Board held:

> [T]here is no claim that competition would be reduced or a monopoly created. BBRR [the shortline] would simply replace CSXT as the carrier for all traffic originating or terminating on these Lines other than the Martin Marietta traffic mentioned above. . . . Our assessment of the relevant provision of the lease is consistent with [the shortline president's] view that BBRR will be able to offer shippers similar interchange options to those available under CSXT's operation of the Lines. Accordingly, we find no

> restraint of trade or other anticompetitive effects likely to result from the proposed transaction. [Slip op. at 6-7.][4]

In sum, the ICC and the Board have consistently held, every time they examined a particular paper barrier, that there was nothing anticompetitive about a paper barrier that simply maintains the *status quo*. Yet WCTL and its supporters now ask the Board to initiate a rulemaking proceeding premised on the opposite conclusion—that paper barriers that leave shippers and connecting carriers in the same position they were before the transaction are presumptively ***anti***competitive. WCTL's principal argument for why the Board should now consider a position that is diametrically opposed to the Board's and the ICC's prior position is that in 2001, in *Major Rail Consolidation Procedures,* the Board adopted a new "competition-enhancing" policy that they claim should apply to the myriad transactions in which railroads sell or lease individual lines—not just to major mergers of Class I railroads. WCTL Comments at 20-21. But the Board could not have made clearer, both in its decision in *Major Rail Consolidation Procedures* and in the resulting regulations, that the foundation for its requirements that major merger applicants offer "competition-enhancing" measures was its conclusion that such measures would be necessary to offset anticompetitive effects of major mergers (such as "loss of geographic competition" and "transitional service disruptions") that could not otherwise be mitigated. *Major Rail Consolidation Procedures,* slip op. at 16-21, 73; 49 C.F.R. § 1180.1(c) and (d). There was nothing in that decision or its regulations that suggested that the STB intended to apply a new "competition-enhancing" standard to anything but the largest Class I rail mergers.

[4] Vice Chairman Mulvey dissented from the Board's decision on the ground that the paper barrier would operate as a "restraint of trade" in the region. Slip op. at 13. We address in Part I.B. below the logical and legal problems with applying a "restraint of trade" label to paper barriers.

In fact, the Board specifically exempted from the new rules even a merger between a smaller Class I railroad, Kansas City Southern Railway Company ("KCS") and a larger Class I railroad, on the ground that such a merger would not be as likely to raise the same anticompetitive concerns and risks as a merger of two large Class I railroads. Slip op. at 15-16. Thus, the merger rules previously in effect continue to apply to such a transaction. 49 C.F.R. § 1180.0(b). Further, as illustrated by the *Buckingham* case, by statute the Board may not apply a "competition-enhancing" requirement to merger or control transactions not involving two Class I railroads. The Board must approve the transaction unless it finds "a substantial lessening of competition, creation of a monopoly, or restraint of trade" and that "the anticompetitive effects of the transaction outweigh the public interest in meeting significant transportation needs." 49 U.S.C. § 11324(d). If a transaction between two existing shortline and Class I carriers is subject to that kind of traditional standard, there is no conceivable justification for subjecting a transaction between a new shortline carrier and a Class I carrier to a higher "competition-enhancing" standard.

None of the other arguments made by supporters of a rulemaking suggests how the ICC's and the Board's decisions in *Montana Rail Link, Grainbelt, South Carolina, Portland & Western,* and *Buckingham* were wrong. Instead, they make exactly the same arguments that were made by the opponents of the paper barriers in those cases about paper barriers "restraining competition," without the slightest effort to answer how it is that competition is more "restrained" with paper barriers than if the Class I railroad did not enter into the transaction at all.[5] Several of the shipper commenters describe specific situations in which they assert they

[5] WCTL attaches the Verified Statement of Paul S. Dempsey, who makes the remarkable argument that Class I railroads and shortlines enter into transactions involving paper barriers because it makes both the Class I and the shortline financially better off (which can only happen if they offer more efficient service together than the Class I could offer on its own) and the railroads' customers "bear the consequences." VS Dempsey at 3. He nowhere

would be better off without paper barriers on the lines that serve them, but all of their comments assume that the transaction that permitted the shortline to operate as the serving carrier could have taken place without the paper barrier.[6] All of the evidence is to the contrary. The Verified Statement of Warren C. Wilson, submitted by Union Pacific Railroad ("UP"), explains in some detail why such transactions cannot take place, or remain in place, without paper barriers, and the AAR's and ASLRRA's Comments emphatically confirm that paper barriers are at the heart of these deals. In particular, "ASLRRA concludes that without the boundaries and predictability that paper barriers create for divesting class I carriers, a large number of its members would never have been created in the first place." ASLRRA Comments at 3. Further, "[i]it is unrealistic to suggest that if 'requirements' provisions (paper barriers) in line acquisition or line lease agreements are eliminated, the value of resulting lost business to the divesting carrier can simply be structured into a front end premium on the sales or lease price for the line." Id. at 4.

In short, there is no more evidentiary basis today than there has been in the past for finding a "problem" with paper barriers that need fixing. By the same token, there is no less reason today for the Board to permit Class I railroads and shortlines to use paper barriers to enter into "win-win" lease or sale transactions than there was in the past. Indeed, the success of the RIA in providing a forum for Class I railroads and shortlines to address issues arising under

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makes clear what he thinks those (presumably adverse) consequences would be. The Class I railroad cannot charge more for through service to the shipper than it charged before. As the ICC discussed in *Montana Rail Link,* however, together the Class I and the smaller railroad may be able to provide more efficient, effective service. That could not possibly hurt the shipper.

WCTL proffers another alternative, which is that the Class I railroads abandon lines rather than try to make them more profitable through "win-win" deals with shortlines. WCTL Comments at 21-22. Of course, abandonment of a line with active shippers is no easy process, and it is usually preceded by years of deteriorating service as the railroad serving the line struggles to make a profit. It is difficult to believe that WCTL or any other shipper association would prefer to see a line abandoned than for the Class I railroad to work with a shortline partner to provide more efficient and economic through service.

[6] See Roseburg Comments at 2-4; Marshall Durbin Comments at 3-5; Entergy Comments at 2-5; Arkansas Electric Comments at 4-9; Ameren Comments at 5-9.

paper barriers provides even more reason today to encourage these kinds of mutually beneficial contractual arrangements. Further, as we discuss next, the efforts of WCTL and others to avoid the evidentiary deficiencies in their position by casting antitrust aspersions at paper barriers is baseless.

### B. Paper Barriers Do Not Constitute A "Restraint On Trade" At All, Much Less An "Unreasonable" Restraint

A common refrain in the comments of those who question paper barriers is that they constitute a "restraint of trade" that ought to be remedied by the Board. Some go so far as to suggest that paper barriers involve improper "tying" or "price fixing" or some other antitrust bogeyman.[7] Nothing could be further from the truth.

When a Class I railroad leases or sells track to a shortline with a paper barrier, it typically does so at a lower price because it is assured that it will continue to participate in the long-haul traffic on the line. Usually, it is clear that the shortline is not paying the going concern value of the line as part of the Class I railroad's long-haul system. Rather, the shortline buys the right to provide local service over the line and to work with the Class I railroad to develop and provide long-haul traffic. The Class I railroad does not "tie" one product to another.

This is no more a "restraint of trade" than a railroad electing to sell "bridge-only" or "overhead" trackage rights to another railroad at a lower price than it would sell local trackage rights that permitted the tenant to serve shippers on the line. Nothing requires the landlord to sell "all-inclusive" trackage rights, and nothing requires the tenant either to buy "all-inclusive" trackage rights or none at all. There is no "restraint." There is only a sale of limited rights between a willing buyer and a willing seller.

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[7] See USDA Comments at 4 ("restraint of trade"); Ameren Comments at 13-14 ("restraint of trade"); WCTL Comments, VS Dempsey at 6 ("tying" and "exclusive dealing"); NASSTRAC Comments at 6 ("market division" and "price fixing"); ARC Comments at 7-8 ("price fixing" and "division of markets").

To be sure, a shipper on the line may think that there is some sort of restraint, because it does not have access to the tenant railroad (in the case of overhead trackage rights) or access to another long-haul carrier through the shortline (in the case of a lease or sale of the line subject to a paper barrier). But the "restraint" here is no different than the "restraint" to which the shipper would be subject if the Class I railroad owning the line elected not to enter into any transaction. A shipper may prefer to be served by multiple carriers, but there is no "restraint of trade" involved in a Class I railroad structuring a line sale or lease so as to preserve and grow its long-haul business. Neither the antitrust laws nor any regulatory precept under the Interstate Commerce Act, as amended by the ICC Termination Act, calls into question a railroad's right to price its services to reflect its exclusive access to a shipper. Indeed, railroads are ***expected*** to "differentially price" their business, charging higher rates to shippers with higher demand. See *Coal Rate Guidelines—Nationwide,* 1 I.C.C.2d 520, 539 (1985).

Line sale or lease transactions with paper barriers do not alter the competitive options available to shippers. From a competitive standpoint, as the ICC and the Board have repeatedly recognized, the parties are simply maintaining the *status quo.* If that is a "restraint of trade," then it is certainly not an "unreasonable" restraint of trade, because it permits an efficiency-enhancing transaction to go forward without diminishing one whit the competitive options of the shipper, or enhancing one whit the market power of the Class I railroad. See *Arizona v. Maricopa County Medical Society,* 457 U.S. 332, 342-43 and n. 13 (1982) (explaining that the prohibition in the Sherman Act on agreements "in restraint of trade" has never been read literally, and that most restraints are generally analyzed under a "rule of reason" that requires the factfinder to consider "'the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; that nature of the restraint and its effect, actual or probable'" to determine whether the restraint is "unreasonable") (citing *Chicago Bd. Of Trade v. United States,* 246 U.S. 231, 238 (1918) (Brandeis, J.)).[8]

The notion that there is any "price-fixing" involved in arrangements under which a Class I railroad retains all of the responsibility for marketing, administering, and pricing through long-haul service is equally untenable. As the Board well knows, railroads frequently enter into haulage and switching arrangements with each other—where one railroad manages and prices the through business to the shipper and the other provides haulage or switching services at a set per-car fee—with no involvement by the Board, and no need for its involvement. See, e.g., ICC Finance Docket No. 30918, *KRENCO, Inc., d/b/a/ Keokuk Junction Ry.—Acquisition and Operation Exemption—The Atchison, Topeka and Santa Fe Ry.* (served April 28, 1988), aff'd sub nom. *Simmons v. ICC,* 871 F.2d 702 (7th Cir. 1989) (no jurisdiction over haulage agreements). These kinds of inter-carrier arrangements are ***encouraged.*** See, e.g., Ex Parte No. 334 (Sub-No. 8), *Joint Petition for Rulemaking on Railroad Car Hire Compensation,* 9 I.C.C.2d 80 (1992) (adopting market-based approach to car hire, and encouraging bilateral agreements). Indeed, in *Major Rail Consolidation Procedures,* the Board determined that "private-sector

[8] A number of the commenters suggest a variety of ways in which restrictions could or should be placed on the length of paper barriers. WCTL Comments at 22-23; USDA Comments at 6. But this assumes that at some point the "restraint" posed by a paper barrier becomes unreasonable. As we discuss below in connection with the question of "non-compete" agreements, when a paper barrier lies at the heart of a deal, it makes no sense to talk about terminating the paper barrier any sooner than the parties negotiated that it be terminated. Terminating the paper barrier means terminating the deal, unless the parties have negotiated for something else. And the Board is signally poorly placed to try to determine for itself what the useful life is of a paper barrier. What if, as illustrated by UP's 1992 lease to the Missouri & Northern Arkansas Railroad ("MNA"), the shortline pays ***no*** rent to the Class I railroad if it interchanges all, or almost all, of its interline traffic with the Class I railroad, and the shortline has ***never*** paid any rent to the Class I railroad for leasing hundreds of miles of track. Statement of Warren C. Wilson filed March 8, 2006 at 6-7. Aside from the question of how the Board could possibly determine that UP's lease might become anticompetitive, when would that be? How could the Board possibly establish a generic presumption that such a paper barrier ought to terminate at some particular point, and how (as we discuss further in Part II below) could the Board deal with the constitutional compensation issues that would arise if the paper barrier were terminated and the line were not returned to UP? Entergy and AECC both specifically complain about the MNA lease, but neither suggests how it is any more "anticompetitive" today than it was in 1992 or will be in the future. In short, the idea that paper barriers should be subject to some arbitrary time limit is no more convincing than the root argument that they constitute "restraints on trade."

initiatives, such as joint marketing agreements and interline partnerships, can produce many of the efficiencies of a merger while risking less potential harm to the public." Slip op. at 16-17; 49 C.F.R. § 1180.1(c).

The Supreme Court also had occasion recently to address the issue of "price-fixing" in the context of joint ventures. *Texaco Inc. v. Fouad N. Dagher,* 126 S. Ct. 1276 (2006). In that case, a joint venture between two oil companies had been approved by the Federal Trade Commission ("FTC"), but a divided Ninth Circuit determined that the joint venture's pricing activities constituted unlawful "price-fixing." The Supreme Court unanimously reversed—starting with the proposition that "'[T]his Court has long recognized that Congress intended to outlaw only *unreasonable* restraints.'" 126 S. Ct. at 1279 (citing *State Oil Co. v. Khan,* 522 U.S. 3, 10 (1997) (emphasis in original). Thus, "plaintiffs must demonstrate that a particular contract or combination is in fact unreasonable and anticompetitive before it will be found unlawful." Id. Since the oil companies in that case did not compete with each other in the relevant market, the Court concluded that while the joint venture's pricing policy "may be price fixing in the literal sense, it is not price fixing in the antitrust sense." Id. at 1280 (citing *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.,* 441 U.S. 1, 9 (1979)). The Court also held that the joint venture's pricing activities could not be attacked as an "ancillary" restraint, because "the business practice being challenged involves the core activity of the joint venture itself." Id. at 1281.

The *Dagher* decision is instructive here as well. The Court noted that the challenge there was to "an important and increasingly popular form of business organization," id. at 1279, which should not be discouraged absent a demonstration that it adversely affected competition. Here, the Board is considering a very popular form of business arrangement between Class I railroads and shortlines that, like the joint venture in the *Dagher* case, offers synergies and rail growth opportunities without reducing competition. Calling it a "restraint of trade" or "price fixing" without assessing whether it actually reduces competition does nothing to advance the analysis, because it is only ***anticompetitive*** restraints of trade that are disfavored.[9] The Board and the ICC have already determined that there is nothing anticompetitive about paper barriers that simply maintain the competitive status quo, and neither WCTL nor any of its supporters in this proceeding have demonstrated how those prior decisions were wrong.

Moreover, *Dagher* illustrates why analogies to "non-compete" provisions and other such restrictions that are ancillary to the sale of a business that will operate completely independently from the seller are inapt. See, e.g., WCTL Comments, VS Dempsey at 5. As a general matter, such provisions are upheld so long as they are reasonably limited in time and scope. See, e.g., *Sound Ship Bldg. Corp. v. Bethlehem Steel Corp.,* 387 F. Supp. 252 (D. N.J. 1975) (upholding 20-year restrictive covenant). But, as the Court in *Dagher* made clear, there is no place for consideration of whether an "ancillary" restraint on nonventure activities is reasonable when the restraint at issue involves the "core activity" of the venture itself. 126 S. Ct. at 1281. When a Class I railroad uses a paper barrier in conjunction with a line sale or lease, the shortline provides originating and terminating rail services, and the Class I railroad provides the long-haul services. The paper barrier makes possible these mutually beneficial joint railroad activities. Without it, there would be no cooperative arrangement between the railroads to preserve and grow rail traffic on light density rail lines. Thus, it makes no sense to consider the circumstances under which a restrictive covenant would be upheld, and for how long, ***if*** (contrary to their express intentions) the railroads had contracted to work apart in competition with each other.

[9] By the same token, asserting that there is "exclusive dealing" or "division of markets" going on—when one railroad contracts with another to enter into a joint arrangement to provide services that the first railroad previously provided alone—is fallacious on its face. It is certainly not "exclusive dealing" or "division of markets" for a Class I railroad to provide the service by itself in the market, so how can it be "exclusive dealing" or "division of markets" for the Class I to work in conjunction with a shortline railroad (usually newly created) to provide that service?

In sum, antitrust epithets like "restraint of trade" and "price fixing" are just as inapplicable to paper barriers now as they have been in the past, when the Board and the ICC correctly determined that there is no legal or policy reason for regulatory intervention into these private contractual arrangements.[10] Moreover, as we discuss next, the RIA today addresses abuses of paper barriers, and, in any event, shippers have the same regulatory protection against rate and service abuses on lines that are subject to paper barrier as they have on lines that are not. There is no basis for a rulemaking proceeding to single out lines that are subject to paper barriers for any special regulatory treatment.

### C. The RIWG Has Established A Strong Cooperative Relationship Under The RIA That Militates Against Any Abuse Of Paper Barriers, And Shippers Have The Same Regulatory Protection Against Rate And Service Abuses On Lines That Are Subject To Paper Barriers As They Have On Lines That Are Not

Class I railroads and their shortline partners have a strong interest in working closely together to achieve the goals of their agreements, including building through business with their customers. That is why in 1998 the AAR and the ASLRRA sponsored discussions among participating large and small railroads concerning a variety of inter-carrier issues, including paper barriers. After the Board in April 1998 conducted two days of informational hearings in Ex Parte No. 575, it applauded the AAR/ASLRRA discussions and urged a private-sector resolution of the issues of the application of paper barriers, inadequate car supply, and lack of alternative routings that had been raised by the shortline railroads. In September 1998, the AAR

[10] Ameren's citation to other agencies' regulation of agreements and conduct in other industries that those agencies found anticompetitive puts the rabbit in the hat. Ameren Comments at 19-20. Since the ICC and the Board have never found that paper barriers are anticompetitive—and the proponents of a rulemaking here have made no such demonstration—there is no parallel to those other agencies' actions.

and ASLRRA reached agreement, and all of the Class I railroads and most of the shortline railroads became signatories to that agreement.[11]

Under the RIA, the railroads agreed that only "legitimate" paper barriers, which are "designed as fair payment for the sale or rental value of the line that created the Short Line," are enforceable. RIA at 3. With respect to Class III carriers in particular, the railroads agreed to the general premise that if requested access or routing would help the shortline and would not harm the Class I railroad, then the request should be approved—since it will improve service to shippers while strengthening the rail industry. RIA at 4. This includes waiving paper barriers under a variety of Guidelines for Paper Barriers and New Routes. RIA, Exh. C.

The RIA has been a substantial success. As confirmed by the comments of both the RIWG and the ASLRRA, "the RIA has been an effective private sector framework for the reasonable interpretation and use of paper barriers." ASLRRA Comments at 2; RIWG Comments at 5. To facilitate the effective operation of the RIA, the railroads created the RIWG[12] to "go beyond anecdotal statements and assess how the paper barrier provisions—as well as the rest of the RIA provisions—were actually working." RIWG Comments at 3. A process was established by which smaller railroads could submit requests to the applicable Class I railroad for waivers of paper barriers, and for the railroads to report on those requests and their disposition; smaller railroad members were also encouraged to present any concerns they have regarding paper barriers directly to one of the smaller railroad representatives on the RIWG. Id. at 4. The small number of requests for relief under all of the provisions of the RIA (approximately 75 since the process was instituted in 2002) is indicative of the relatively low

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[11] The RIA, as amended, is attached as Appendix B to the AAR's Opening Comments and Appendix 3 to the ASLRRA Comments.

[12] The current membership of the RWIG is set forth in Appendix 1 to the RWIG Comments.

level of inquiries and concerns. Id.[13] Nevertheless, in response to concerns about the definition of "New Traffic" in the RIA, the AAR and the ASLRRA formally amended and expanded that definition in 2004. RIWG Comments, App. 3, Attachment 1.

WCTL and some other shipper commenters in this proceeding, as well as the United States Department of Agriculture ("USDA"), complain that the RIA does not provide for formal input by shippers and communities, and does not provide for the elimination or restructuring of what they deem "unreasonable" paper barriers.[14] But their complaints in this regard are misguided on several levels. First, shippers and communities are also not directly involved in the negotiation, implementation, or administration of trackage rights agreements, haulage agreements, joint marketing agreements, through rate divisions agreements, reciprocal switching agreements, interchange agreements, car hire agreements, or most of the other inter-carrier agreements that are common and necessary to the operation of the nation's rail system. The reason that the RIA was developed was that the shortlines had concerns about some elements of their contractual relationships with the Class I railroads, and the AAR and the ASLRRA believed they could be of assistance in establishing a process for the parties to those contracts to air their concerns and resolve any disputes. While shippers and communities certainly have a legitimate interest in the economic and efficient operation of the nation's transportation system, they do not

[13] Most of the waiver requests were granted. RIWG Comments at 4. Also, the AAR and the ASLRRA set up a non-binding mediation process available for disputes involving paper barriers, which has been used in three instances. Id. at 5 n. 2. Only one request for arbitration has been filed with the Board under the terms of the RIA, and that request was subsequently withdrawn with prejudice. See STB Docket No. 42076, *Albany & Eastern Railroad Company v. The Burlington Northern and Santa Fe Railroad Company* (served January 12, 2004). The only shortline railroad (out of over 400 in the country) that has filed comments in support of the WCTL request for a rulemaking is the shortline that withdrew its arbitration request. That shortline states here, as it has before, that it withdrew its arbitration request because the RIA allegedly does not provide relief from "unreasonable" paper barriers. AERC Comments at 4. BNSF responded to AERC's earlier filing in this proceeding by letter filed May 20, 2005. BNSF observed that AERC's real complaint is that, having paid only a relatively nominal value for the track it acquired from BNSF, AERC could not use the RIA to re-write its agreement with BNSF and acquire access to traffic for which it did not pay a full franchise value. BNSF May 20, 2005 Letter at 2. That certainly does not suggest any deficiency in the RIA. ASLRRA Comments at 2-5.

[14] See WCTL Comments at 2, 24; NASSTRAC Comments at 5-7; ARC Comments at 11; USDA Comments at 7-8.

normally have a right of access to or involvement in commercial arrangements between private companies involved in the transport supply chain—including large or small railroads, trucking companies, barge lines, or maritime enterprises.

Second, shippers are not shy about making their concerns known to railroads about the smooth functioning of their service or the level of their rates, regardless of whether there is a paper barrier on a line. If a shipper has a problem related to a paper barrier, it can certainly make its concerns known to the Class I railroad and/or shortline involved. If the railroads have differences of opinion or interpretation regarding the paper barrier, the RIA provides a means to assist in resolving such differences. In fact, the RIA has done a very good job of helping resolve such differences. The complaint of the shippers here is ***not*** really that they cannot formally intervene in the resolution of a paper barrier dispute between a Class I railroad and a shortline. Their complaint is that they sometimes do not like the ***results*** of the RIA process, which recognizes legitimate paper barriers and enhances the cooperative relationship between the shortlines and their Class I partners.

Third, if a shipper believes that its rates or its services have been adversely affected by a paper barrier, the shipper has the same rights to invoke the Board's regulatory remedies to challenge those rates or seek better service with respect to lines that are subject to paper barriers that the shipper has with respect to lines that are not. Although shipper associations like the Alliance for Rail Competition ("ARC") would like to use paper barriers as an excuse to engineer broad "competitive access," their arguments for regulatory intervention to require such access are no different here than the arguments they have advanced in the past for "open access" across the nation's rail system. ARC Comments at 5. There is no difference under the Board's competitive access rules between a demand for the prescription of a through route or a joint rate, or involuntary access to a terminal area, for a line with a paper barrier than for a line without. See 49 C.F.R. § 1144.[15] Those rules lay out in detail what steps the complainant must take, and what proof it must make, in order to obtain relief. Contrary to ARC's suggestion, a paper barrier provides no more evidence of an "anticompetitive act" under those rules than a decision by a Class I railroad to decline to hand over its traffic to another railroad by opening up a terminal to reciprocal switching or by "short-hauling" itself on a through movement. ARC Comments at 7-8. If the shipper or a connecting carrier believes that the Class I carrier has acted anticompetitively, it has to prove it under the competitive access rules in a particular case. It cannot use the "paper barrier" talisman to try to perform an end run around those rules.

In sum, the RIA is doing exactly what the railroads hoped it would do—helping to resolve conflicts between the railroads involved about the proper interpretation and application of the paper barriers they entered into as part of sale or lease transactions designed to improve the efficiency and economy of their service. The assertion that the RIA process has failed because it has not permitted shippers to attack legitimate paper barriers as "anticompetitive" is seriously misguided. The Board and the ICC have repeatedly found that there is nothing "anticompetitive" about the paper barriers the agency has examined, and none of the antitrust slogans used by the shipper proponents of a rulemaking here makes any logical or legal sense.

If the Board adopted a general rule restricting the use of paper barriers, the effect would be to discourage an "important and productive" business tool in the railroad industry for achieving more efficient and economic rail service. ASLRRA Comments at 3. The Board has repeatedly recognized the value of paper barriers in encouraging "win-win" cooperative rail

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[15] See also *Central Power & Light Co. v. Southern Pac. Transp. Co.*, 1 S.T.B. 1059 (1996), 2 S.T.B. 235 (1997), aff'd sub nom. *MidAmerican Energy Co. v. STB*, 169 F.3d 1099 (8th Cir. 1999) (affirming long-haul carriers' general right to specify the particular routes and interchange points over which they will move traffic, and the form of the rates that will apply).

service ventures between long-haul and shortline railroads. The Board should not start a rulemaking proceeding that would discourage the continued use of paper barriers in shortline sale or lease transactions. And, as we discuss next, it would be a particularly serious mistake for the Board to embark on a rulemaking in this area for lines that are already subject to paper barriers.

## II. IT WOULD BE PARTICULARLY ILL-ADVISED FOR THE BOARD TO INITIATE A RULEMAKING PROCEEDING THAT COULD CALL INTO QUESTION PRE-EXISTING PAPER BARRIERS

### A. The Board Has Limited Authority To Reopen Settled Transactions, And It Cannot Revoke An Exemption To Reopen A Transaction That Continues To Comport With The Class Exemption Rules

The commenters who are critical of paper barriers generally urge the Board to promulgate a rule that would apply not only prospectively to paper barriers in future agreements but also retroactively to paper barriers in existing, consummated agreements. These commenters suggest, for instance, that the Board mandate the sunsetting of paper barriers at a certain point in time after the agreement containing the paper barrier has been consummated,[16] that the Board promulgate rules to determine when it might be appropriate to terminate a paper barrier even sooner than when the mandatory sunset rule would otherwise dictate,[17] and that the Board create presumptions or otherwise act to generally eliminate existing paper barriers.[18] As noted above, all of these suggestions would result in the elimination of ***essential*** terms of consummated sales or lease agreements—agreements that were consummated in reliance ***both*** upon the ICC's or Board's approval of the particular transaction ***and*** the ICC's or Board's consistently-stated position that paper barriers are not anticompetitive and that, when they engage in such sale or

[16] See WCTL Comments at 2 n.2, 23; Ameren Comments at 21; NGAF Comments at 3-4.

[17] See Ameren Comments at 21-22.

[18] See ARC Comments at 10; Wheat & Barley Commission Comments, *passim*; NASSTRAC Comments at 7-8; Roseburg Forest Comments, *passim;* USDA Comments at 9.

lease transactions, carriers are not required to ***increase*** the existing level of competition. See, e.g., *Portland & Western,* slip op. at 6 ("The Board and the Interstate Commerce Commission have consistently held that carriers are not obligated to increase the existing level of competition when they undertake sale or lease transactions such as this.").

The elimination of these essential terms of sale or lease agreements would retroactively abrogate rights that vested when, with the approval of the ICC or Board, the sales and lease agreements were executed. By the same token, the elimination of these terms would impose a new liability—that is, the loss of the line or its use without adequate compensation—that did not exist when the transactions were consummated. Thus, the commenters are asking this Board to engage in a retroactive rulemaking. See *Landgraf v. USI Film Prods.*, 511 U.S. 244, 280 (1994) (retroactive provision is one that "would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed."); *Bergerco Canada v. U.S. Treasury Dep't*, 129 F.3d 189, 192 (D.C. Cir. 1997) (explaining that regulation challenged in *Bowen v. Georgetown University Hosp.*, 488 U.S. 204 (1988), was retroactive because the rule in force when the respondent hospitals "performed their services gave them a legal right to reimbursement at one rate," and the "Secretary's later rulemaking extinguished that right, replacing it with a right to reimbursement at a lower rate").[19]

Because none of the statutory provisions cited by the commenters contains an express grant of authority to engage in such retroactive rulemaking, their proposed rules would be invalid. See *Bowen*, 488 U.S. at 208-216 (holding that agency did not have power to promulgate retroactive rules because authorizing statute did not expressly provide such power to agency);

[19] In *Bergerco Canada*, the agency action was not found to be retroactive, in part because the appellee had not detrimentally relied upon the rule that had been changed. See *Bergerco Canada*, 129 F.3d at 195. Here, by contrast, rail lines were sold or leased to shortlines in express reliance upon the ICC's or Board's exemption of those transactions from regulation, or approval of an application, and the retroactive elimination of paper barriers would abrogate rights that vested upon the consummation of the transactions.

see also id. at 208 (stating that "a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms"); *Sierra Club v. Whitman*, 285 F.3d 63, 68 (D.C. Cir. 2002) ("We have held that the [Administrative Procedure Act] prohibits retroactive rulemaking.") (internal citations omitted).[20]

By the same token, none of the statutory provisions cited by the commenters could be deemed to permit a taking of property without just compensation, although that is what the commenters are advocating. That this is exactly what the commenters are urging is most plainly evident with regard to the many transactions in which the paper barrier was the principal consideration for the transaction. In many line sales and leases, the shortline either paid no sales price or rent, or the sales or rental payments were deferred for years. In such cases, the elimination of existing paper barriers sought by many of the commenters would effect a transfer from the Class I railroad to the shortline ***without compensation***—which clearly would be an unconstitutional taking.

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[20] It is important to distinguish retroactive agency action in the adjudicatory context, where it is permitted in certain circumstances, from the promulgation of retroactive ***rules***. See *Bowen*, 488 U.S. at 209 (noting that the authority conferred by statute for retroactive "case-by-case adjudication" did not authorize retroactive rulemaking). This is due, in part, to the fact that, under the Administrative Procedure Act, a rule "means the whole or part of an agency statement of general or particular applicability ***and future effect*** designed to implement, interpret, or prescribe law or policy . . . ." 5 U.S.C. § 551(4) (emphasis added). See *Sierra Club*, 285 F.3d at 68 (stating that APA "prohibits retroactive rulemaking").

The rule sought here would be retroactive in the full or primary sense of the term, because, as noted above, it would invalidate rights arising out of past transactions involving paper barriers, and would impose new liabilities for undertaking those transactions. Even if, however, a rule eliminating paper barriers in consummated transactions could be characterized as imposing only "secondary retroactivity"—which refers to purely future effects that impinge upon the value of past transactions (see, e.g., *Bergerco Canada*, 129 F.3d at 192)—the rule would properly be held to be arbitrary and capricious. A rule marked by secondary retroactivity is subject to review to determine whether the rule is "reasonable, 'both in substance ***and in being made retroactive.***'" *Celtronix Telemetry, Inc. v. FCC*, 272 F.3d 585, 589 (D.C. Cir. 2001) (quoting *U.S. Airwaves, Inc. v. FCC*, 232 F.3d 227, 233 (D.C. Cir. 2000); emphasis in original). As Justice Scalia noted in his concurrence in *Bowen*, "[a] rule that has unreasonable secondary retroactivity—for example, altering future regulation in a manner that makes worthless substantial past investment incurred in reliance upon the prior rule—may for that reason be 'arbitrary' or 'capricious,' and thus invalid." *Bowen*, 488 U.S. at 220 (Scalia, J., concurring) (citation omitted). Here, a rule eliminating paper barriers would render "worthless" (or even worse) transactions undertaken "in reliance upon the prior" ICC or Board decisions granting exemption petitions to carry out the transactions.

In ***all*** cases, however, the paper barrier was an essential term of the agreement and provided at least a substantial part of the consideration for the transaction. The rights flowing from the paper barriers vested with the consummation of the transaction, and the elimination of the paper barrier would retroactively eliminate those vested rights and a substantial portion of the value of the property. Because the commenters are not seeking to have each shortline sale or lease transaction rescinded in its entirety, but rather are seeking to eliminate only the paper barriers in such transactions, the commenters are, in effect, seeking Board-mandated sales or leases at sharply reduced or even non-existent consideration, which would constitute a taking without just compensation.[21]

As noted, none of the diverse statutory provisions cited by the commenters provide the authority for the Board to engage in sweeping post-transaction, retroactive revocations of vested rights and takings of property. Furthermore, the Board has recognized that sale and lease transactions of the kind at issue here are quintessentially voluntary. Although the Board may impose conditions upon those transactions, the parties remain free to decide whether or not to consummate the transactions, subject to the Board-imposed conditions. To radically revise the conditions for a transaction ***after*** it has been consummated and cannot easily be unwound would improperly eliminate the voluntary nature of the transactions. See, e.g., *Guilford Transp. Indus., Inc. – Control –Boston & Maine Corp.*, 5 I.C.C.2d 202, 206 (1988) (recognizing "obvious" unfairness of request for trackage rights "made long after the control transactions were consummated and consolidated operations were effected" when "consolidating carriers had no

[21] There is no basis for arguing that paper barriers that remain in effect for arbitrary periods —such as five years— would allow long-haul railroads to be fully or adequately compensated for the lines leased or sold in shortline transactions. To the contrary, such an assumption makes little sense, since the full value of the line could be based in substantial part on its potential revenue stream into the indefinite future, rather than for an arbitrary period, particularly as short as five years. See USDA Comments at section titled "Unreasonably long contract terms" (noting that the five-year sunset provision advocated by WCTL may be too short).

advance knowledge at the time of consummation," and pointing out that the "problem is compounded" because the agreement of the carriers to the transaction "is essential," and a post-consummation imposition of a trackage rights condition would "lack the element of agreement").[22]

Although the commenters seek to portray various provisions as the grant of a roving commission to reopen past transactions and redesign the railroad regulatory landscape, the Board and the ICC have taken a more responsible view of their statutory authority. Thus, for instance, there is no basis for the attempt by some of the commenters to suggest that 49 U.S.C. §§ 722, 10502(d), and/or 10704 can support the rulemaking they seek. The Board has expressly recognized that retroactive remedies are unavailable under a number of the cited provisions. For instance, with regard to 49 U.S.C. § 10704—which WCTL asserts could be used to eliminate already-established paper barriers (WCTL Comments at 14)—the Board has recognized that this provision does not authorize retroactive remedies (in the form of reparations) for rates that were previously found to be lawful. See STB Ex Parte No. 657 (Sub-No. 1), *Major Issues in Rail Rate Cases* (served Feb. 27, 2006) ("*Major Issues*"). In *Major Issues*, the Board stated that, although it would be lawful to lift "the prescriptive effect of a rate prescription once the evidence justifies reopening a case, and then at the end of the investigation [to change] a rate prescription retroactive to the date of the reopening," it would be inconsistent with *Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Ry.*, 284 U.S. 370 (1932), to "award reparations to a complaining

[22] Outside of the limited context of the ICCTA's feeder-line provisions (49 U.S.C. § 10907(b)(1)), there is no basis for the Board to second-guess the economic valuations arrived at through negotiations between the parties and thereby compel the parties to enter into a sale or lease transaction on financial terms that they—especially, the selling or leasing railroad—regard as unacceptable. But this is exactly what the retroactive elimination of paper barriers in existing contracts would involve. Moreover, even in the case of feeder line sales, the line's owner must receive a price "not less than the constitutional minimum value" of its assets, which is the greater of the line's going concern value and its net liquidation value (49 U.S.C. 10907(b)(1) & (2)), a point that we discuss in greater detail below.

shipper with respect to past shipments that had moved under previously prescribed rates." Slip op. at 38. See also STB Docket No. 41185, *Ariz. Pub. Serv. Co. v. The Burlington N. & Santa Fe Ry. Co.* (served May 12, 2003), slip op. at 7 (similar).[23]

The same bar on retroactivity that applies to rates should be applied to practices—such as paper barriers—approved by the Board under its authority to exempt or approve applications for trackage lease or sale transactions. Consequently, it stands to reason that 49 U.S.C. § 10704 also could not be used to retroactively eliminate practices under paper barriers (absent some sham or other defect that renders the decision approving the practice void ab initio). Moreover, there is no basis for limiting the holding in *Arizona Grocery* just to 49 U.S.C. § 10704. Rather, it clearly should be applied to all of the statutes cited by commenters.[24]

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[23] Similarly, in *Major Rail Consolidation Procedures*, the Board stated, "While we have express authority under 49 U.S.C. 11327 to issue supplemental orders in appropriate situations in rail merger cases, that authority must necessarily be used very cautiously and sparingly once the parties to an approved merger no longer have the opportunity to elect not to proceed if they are unwilling to accept all of the conditions that we have placed on our approval of their proposal." Slip op. at 45 n.53.

[24] Several other statutes cited by some of the commenters appear utterly irrelevant to whether the Board has the authority to retroactively eliminate paper barriers. For instance, it is not clear how, under the RIA, legitimate paper barriers could be deemed to violate the requirement of 49 U.S.C. § 10742 that carriers provide "reasonable, proper, and equal facilities" for interchanges, as that statute has been interpreted and applied by the STB. Furthermore, we are not aware of claims by carriers that they are suffering discrimination or even inconvenience in the provision of interchange facilities due to paper barriers, and there has been no showing that Section 10742 either can or should be invoked to hold that paper barriers are per se violations of the requirements of Section 10742. In fact, it appears that Section 10742 is being cited as a surrogate for 49 U.S.C. § 10705—a section that none of the commenters invoked, perhaps because they realize that, under the competitive access rules, they have no viable Section 10705 claim.

By the same token, ARC's invocation of the terminal facilities provisions of 49 U.S.C. § 11102 appears completely beside the point, as does Entergy's reference to the statutory limitation on pooling and division of transportation or earnings set forth in 49 U.S.C. § 11322. Neither provision is relevant to whether the Board has the statutory authority to retroactively eliminate paper barriers.

Section 11327, which by its terms applies only to 49 U.S.C. §§ 11322-11326, is largely irrelevant, because Section 11322 is inapplicable and the great preponderance of shortline transactions occur under 49 U.S.C. §§ 10901 or 10902, not under Sections 11323-11326. Further, as discussed in Part I.A., Section 11324(d) requires approval for a sale or lease transactions involving an existing shortline railroad and a Class I railroad unless an opponent of the transaction shows that competition would be adversely affected by the transaction. A transaction could not lawfully be reopened on a "competition-enhancing" theory when the underlying statute specifically excludes that possibility. Finally, even were Sections 11323-11326 applicable, the Board has expressed a great reluctance to invoke its authority under Section 11327 with regard to consummated mergers. See note 23, *supra*. In addition, as noted below, the Board has repeatedly rejected attempts to use mergers to justify removing paper barriers.

Even if there were some statutory basis for Board action on paper barriers in individual, consummated agreements (such as through a rulemaking providing for just compensation for the loss of the paper barrier), the commenters have failed to show that there is any basis for a wholesale reopening of all existing transactions that include paper barriers. The Board has repeatedly stated that the grounds upon which an exemption may be revoked are quite limited. As the Board explained in STB Docket No. AB-565 (Sub-No. 14X), *New York Cent. Lines, LLC – Abandonment Exemption – In Montgomery & Schenectady Counties, NY* (served Jan. 22, 2004), when a petition is filed under 49 U.S.C. § 10502(d) to revoke an exemption that has become effective, "a revocation request is treated as a petition to reopen and revoke and, under 49 C.F.R. 1115.3(b), the petitioner must specify whether the revocation is supported by material error, new evidence, or substantially changed circumstances. The petitioner has the burden of proof and must articulate reasonable, specific concerns to satisfy the revocation criteria." Slip op. at 3; accord STB Finance Docket No. 32162, *Indiana Hi-Rail Corp. – Lease & Operation Exemption – Norfolk & W. Ray. Co. Line Between Rochester & Argos, IN, and – Exemption from 49 U.S.C. 10761, 10762, and 11144* (served Jan. 30, 1998) ("*Indiana Hi-Rail*"), slip op. at 4.[25] The commenters here have not provided any basis for concluding that they would be able to satisfy these requirements with regard to ***any*** of the paper barrier transactions, much less with regard to all of them.

***First***, there is no basis for concluding that the ICC and Board have committed material error with regard to any of the transactions, and certainly no basis for concluding that the ICC and Board has consistently and uniformly been wrong in granting, in case after case, exemptions for transactions that include paper barriers. Specifically, as we showed above, there is no basis

[25] 49 U.S.C. § 722(c), which also is cited by some of the commenters, requires the same showing. See also *Major Issues*, slip op. at 31.

for concluding that paper barriers are anticompetitive (or otherwise inconsistent with the Rail Transportation Policy).

***Second***, there is no basis for concluding that new evidence warrants reopening any of the transactions, much less all of them. The commenters have not pointed to any new evidence that supports revoking the exemptions or reopening the applications that have been granted.

And ***third***, to the limited extent that the commenters have suggested a change in circumstances of any kind, they have not identified any changed circumstances that would support a reopening of the exemptions for paper barrier transactions. Thus, some of the commenters suggest that various alleged effects of railroad mergers constitute the kind of changed circumstances that warrant the elimination of paper barriers. The mergers, so they say, have deprived shortlines of traffic, making them less viable and leaving them with excess capacity. Wheat & Barley Comm'n Comments at 5-6; Roseburg Forest Comments at 3. The mergers also are alleged to have improved the condition of the large railroads (see ARC Comments at 3) and resulted in reductions of excess capacity on the Class I railroads, "de-marketing" of less desirable freight, higher rates (or reductions in downward pressures on rates), and changes in car supply practices. See id. at 5; Roseburg Forest Comments at 2-4. But these allegations of changed circumstances cannot support the radical regulatory action sought by the commenters here.

For one thing, many of the existing paper barriers resulted from transactions post-dating some or all of the major Class I mergers. Moreover, the commenters do not explain how the removal of paper barriers would resolve the alleged consequences of the mergers. Finally, the commenters ignore the fact that the Board has repeatedly rejected attempts to use mergers to justify removing pre-merger paper barriers. See STB Finance Docket No. 32760 (Sub-No. 21), General Oversight, Decision No. 13, *Union Pacific Corp., et al.—Control & Merger—Southern Pacific Rail Corp., et al.* (served December 21, 1998), slip op. at 11 (stating that "paper barrier issues" "have no connection to the UP/SP merger, which neither rendered any shortline captive to UP nor created or extended any paper barrier") (footnote omitted); *CSX Corp., et al. – Control & Operating Leases/Agreements – Conrail, Inc., et al.*, 3 S.T.B. 196, 276-277 (1998); STB Finance Docket No. 33813, *RailAmerica, Inc.—Control Exemption – RailTex, Inc.* (served Jan. 10, 2000), slip op. at 6; STB Finance Docket No. 33556, Decision No. 37, *Canadian Nat'l Ry. Co., et al. – Control – Illinois Cent. Corp., et al.* 4 S.T.B. 122, 159 (1999).[26]

In addition, the Board has recognized that, in weighing whether to reopen settled transactions, substantial weight must be given to the transacting parties' interests in fairness, repose, reliance, and settled expectations. See, e.g., *Guilford Transp. Indus., Inc.*, 5 I.C.C.2d at 206 (emphasizing unfairness of trackage rights request "made long after the control transactions were consummated and consolidated operations were effected"); *Indiana Hi-Rail*, slip op. at 4 ("No specific time limits apply to the filing of petitions to reopen and revoke exemptions under 49 U.S.C. 10505. However, the time elapsed is relevant and may be a factor in ruling on the merits of a request to reopen and revoke an exemption, particularly when the exemption pertains to a transaction that cannot readily be undone."). As the Board noted in connection with a request to revoke an exemption two and a half years "after the decision had become effective and the transaction had been consummated": "When so much time has elapsed, concerns for administrative finality, repose, and detrimental reliance must be balanced against any benefits to be derived from reopening and revocation of the exemption." *Indiana Hi-Rail*, slip op. at 4-5.

[26] By the same token, complaints about alleged high rates cannot support reopening of the exemptions for transactions that included paper barriers. See *Montana Rail Link,* slip op. at 21 ("As stated above, BGT has complained about what it claims to be improper BN rate actions. We stated in our decision served December 21st that such claims should be presented in a formal complaint proceeding rather than in a revocation proceeding.").

Consistent with these principles, the Board refused to reopen its shortline sale decisions in STB Docket No. AB-33 (Sub-No. 132X), *Union Pacific R.R. Co. – Abandonment Exemption – Rio Grande & Mineral Counties, Co.* (served May 3, 2005). There, the Board stated:

> [W]e find that petitioners have not presented any new evidence that materially affects the agency's earlier decisions in this proceeding, nor have they shown material error. Further, ***concerns for administrative finality, repose, and detrimental reliance*** strongly counsel against reopening. . . . The OFA sale at issue was consummated nearly 5 years ago, and both UP and D&RGHF have relied on the prior Board determination. D&RGHF made a substantial investment as part of its reliance, and UP may have foregone other opportunities to sell the line. Petitioners here thus face a substantial burden in seeking to reopen the proceeding and reverse the outcome at this late date. ***Concerned Citizen's petition, which is largely repetitive of, and seeks to relitigate, matters already considered and disposed of in prior decision*****s**, fails to meet that burden. For these reasons, the petition to reopen will be denied. [Slip op. at 3 (internal citations omitted).]

Here, the "concerns for administrative finality, repose, and detrimental reliance" (*Indiana Hi-Rail*, slip op. at 5) are particularly compelling, because the transactions were not only contingent upon the paper barriers, but were also contingent upon—and became effective only ***after***—the Board's approval of the transactions.

### B. Reopening Settled Transactions To Remove Paper Barriers That Are Integral To Those Transactions Would Raise Intractable Compensation And Restructuring Issues

As the Board has recognized in a variety of contexts, when a carrier is required to transfer a line to another carrier, the transferring carrier must receive the "constitutional minimum value" of the line in compensation for the transfer, and this constitutional minimum value typically is the greater of net liquidation value ("NLV") or going concern value ("GCV"). Thus, in the context of the Feeder Railroad Development Program (49 U.S.C. § 10907 and 49 C.F.R. Part 1151), when a carrier is required to transfer a line to another carrier, the transferring carrier must be compensated "at constitutional minimum value which is presumed to be not less than NLV or

GCV, whichever is higher." ICC Finance Docket No. 32150, *Vast Resources, Inc. – Feeder Line Acquisition – Consolidated Rail Corp. Middletown Secondary Branch* (served Nov. 4, 1992) (per Konschnik, Director of Proceedings), slip op. at 4; see also 49 U.S.C. § 10907(b)(1) & (2). Similarly, when the Board is called upon to establish the amount of compensation for a line under the Offer of Financial Assistance ("OFA") provisions (49 U.S.C. § 10904), the Board may not set a price that is below the fair market value of the line, "which is the greater of (1) the line's going concern value (GCV) for continued rail use or (2) the net liquidation value (NLV) of the rail properties for their highest and best nonrail use." STB Docket No. AB-573X, *Trinidad Railway, Inc. – Abandonment Exemption – In Las Animas County, Co., In the Matter of a Request to Set Terms and Conditions* (served Apr. 17, 2002), slip op. at 3-4. And in the context of a conveyance under the § 402(d) of the Railroad Passenger Service Act ("RPSA"), 45 U.S.C. § 562(d), the ICC also determined that "just compensation" was required and concluded that "going concern value and net liquidation value are most appropriate for use here. The higher of the two constitutes just compensation for the transfer." *National Railroad Passenger Corp. – Conveyance of Boston & Me. Corp. Interests in Connecticut River Line in Vt. and N.H.* ("Amtrak"), 4 I.C.C.2d 761, 763 (1988), rev'd, 911 F.2d 743 (D.C. Cir. 1990), rev'd, 503 U.S. 407 (1992).[27]

These principles apply here. As we established above, the elimination of paper barriers would deprive the long-haul carrier of terms and consideration essential to the transaction,

[27] It is notable that in only the Feeder Railroad Development Program context was there a ***statutory*** specification of the greater of NLV and GCV for fair compensation purposes. Compare 49 U.S.C. § 10907(b)(2) (expressly referring to NLV and GCV) with 49 U.S.C. § 10904(f)(1)(B) (stating that "in no case shall the Board set a price which is below the fair market value of the line") and 45 U.S.C. § 562(d)(1) (referring to "just compensation"). In the OFA context, the requirement to use of the greater of NLV and GCV was self-imposed through a regulation, which provides for the use of the greater of NLV and GCV to establish "fair market value," which, in turn, is recognized as the "constitutional minimum value." See 49 C.F.R. § 1152.27(h)(6) ("Fair market value equals constitutional minimum value which is the greater of the net liquidation value of the line or the going concern value of the line."). In the RPSA context, the ICC adopted the greater of NLV and GCV in the *Amtrak* case after carefully reviewing alternatives and considering the compensation methodologies in analogous contexts.

resulting in a forced sale or rental of the line for far less than the selling or landlord carrier agreed to (and the ICC or Board approved) in the original transaction. Such a Board action would clearly constitute a taking for which just compensation at the "constitutional minimum value" (*Amtrak*, 4 I.C.C.2d at 763) should be provided. But this poses highly complex—indeed, potentially unmanageable—challenges for the Board.

First, if, despite the serious questions about the Board's authority to do so, the Board were to promulgate a rule eliminating existing paper barriers on a classwide basis (either immediately, at a designated time after the consummation of the transaction, or on a case-by-case basis), the Board would be required to assess each transaction containing a paper barrier slated for elimination to determine whether the purchase or lease price, ***without*** the paper barrier, provided the selling or landlord railroad with the constitutional minimum value for the line. This would require complex determinations about the valuation of each line, including the value of the traffic that had been exclusively served by the seller or landlord prior to the transaction. Among the determinations that would be required would be whether that valuation should be calculated as of the time that the transaction was consummated or as of the time the paper barrier would be eliminated.[28]

If, as would be the usual case, additional compensation was due the seller or landlord railroad, a determination then would have to be made concerning who should pay that compensation. Although, at first blush, it might appear logical to make the shortline pay, such a course would itself be a forced transfer, compounding the unfairness of eliminating the paper barrier in the first place. After all, the shortlines intended to engage in the transaction that

[28] There would be no basis for assuming that the sale price or rent negotiated by the selling or landlord carrier and the shortline would constitute the constitutional minimum value. To the contrary, as the ICC noted, the purchase price that a selling or landlord carrier has negotiated with a shortline, however, "may not be relevant in determining the constitutional minimum value, particularly if the agreed price is substantially less than constitutional minimum value we are obligated to find for forced sale." *Vast Resources, Inc.*, slip op. at 4.

included the paper barrier (and a lower sales price or rent), and most have neither asked for the elimination of the paper barriers nor volunteered to compensate the seller or landlord railroad for the loss of the paper barrier.

In addition, many shortlines remain under-capitalized, so that it is not clear whether the shortlines would, in fact, be able to provide the compensation. See ASLRRA Comments at 4. The difficulties that shortlines would have in compensating the selling or landlord railroads would be exacerbated by the fact that the elimination of paper barriers would also eliminate many of the marketing and administrative savings that shortlines currently enjoy under existing paper barriers. Thus, at the same time that the shortlines would be required to find the resources to compensate the selling or landlord railroads for the loss of the paper barriers, the shortlines would find themselves having to expand (or create in the first instance) their own marketing and administration capabilities.

Another option would be to make the shippers pay, but this too would pose great problems. For one thing, the Board clearly lacks the legal authority to ***compel*** shippers (or any other non-provider of transportation) to become a part owner or renter of a line. In addition, identifying the shippers who should be required to compensate the selling or landlord railroad for the taking of its property often would be difficult, if not impossible. Moreover, even if the ***present*** shippers or potential shippers on the line were readily identifiable, it would not be fair to make them pay for a line if ***new*** shippers could later locate on the line and use it without having to share in the obligation to compensate the selling or landlord railroad for the loss of the paper barrier.

Yet another alternative might be for the Federal government to pay. Although, outside the RPSA context (see *Nat'l R.R. Passenger Corp. v. Boston & Me. Corp.*, 503 U.S. 407, 421

(1992)), the Board has not been given eminent domain power, a Board-ordered elimination of paper barriers would expose the Federal fisc to takings claims under the Tucker Act. As the Supreme Court has held, just compensation under the Tucker Act may be available regardless of whether the STB is authorized to exercise the power of eminent domain. See *Preseault v. ICC*, 494 U.S. 1, 13, 15 n.8, 16 n.10, 17 (1990) (holding that claim for just compensation could be brought under the Tucker Act for takings resulting from rail-to-trails conversions, and noting that the ICC's lack of authority to condemn railroad rights-of-way for interim trail use—which the ICC itself had asserted—was irrelevant to whether compensation might be available under the Tucker Act).

Perhaps another alternative would be for the Board to set rates on the line to assure that adequate revenues are set aside over time to compensate the selling or landlord railroad for the loss of the paper barrier. But it is doubtful that a government-administered rate-making system would be lawful or practical, and it almost certainly would not be desirable. The Board only has the authority to ***limit*** rates under 49 U.S.C. § 10704 to a lawful maximum.

Finally, faced with these insuperable problems, the Board might order that the transactions be unwound, and the lines returned to the selling or landlord railroads, or that the shortline transactions be renegotiated. Either option also would be unmanageable. For one thing, it would ensure that many shortlines cease to exist—because they either would lose their lines outright or would be unable to negotiate a purchase or lease of the line at full value (without a paper barrier), for the same reasons that they could not do so in the first place. Such an option also would raise questions about how to ensure that the shortlines are adequately compensated for improvements ***they*** have made to the lines. And if the line were returned to the Class I railroad, it may be entitled to seek compensation from the shortline that was deferred in the original transaction. If there were disputes about any of this, the Board would be placed in the position of having to make factual determinations and commercial judgments about the parties' contractual intentions and obligations.

In short, even if there were a statutory basis for the actions that the commenters urge the Board to take, the Board would be ill-advised to step into this regulatory quagmire. The Board's sound policy, mandated by Congress, has always been to minimize Federal regulatory control over the rail transportation system. 49 U.S.C. § 10101(2). The Board should not accept the invitation of WCTL and its supporters to reverse that position and attempt to substitute its own regulatory judgment about the structure, compensation, and operation of shortline leases and sales for the privately-negotiated deals made by the railroads themselves.

## CONCLUSION

For the foregoing reasons, the Board should deny WCTL's renewed petition for a rulemaking to restrict the use of contractual paper barriers.

Respectfully submitted,

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# GLOSSARY

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| AAR | Association of American Railroads |
| AECC | Arkansas Electric Cooperative Corporation |
| AERC | Albany & Eastern Railroad Company |
| Ameren | Ameren Energy Fuels and Service Company |
| ARC | Alliance for Rail Competition |
| ASLRRA | American Short Line and Regional Railroad Association |
| Comments | Comments in STB Ex Parte 575 filed on or about March 8, 2006 |
| Entergy | Entergy Services, Inc. |
| Marshall Durbin | Marshall Durbin Companies, Odom Industries, Southeast Ready Mix, Inc., and Wayne County Economic Development District |
| NASSTRAC | NASSTRAC, Inc. |
| NGAF | National Grain and Feed Association |
| Reading | Reading Blue Mountain and Northern Railroad Company |
| RIWG | Railroad Industry Working Group |
| Roseburg | Roseburg Forest Products Company |
| UP | Union Pacific Railroad Company |
| USDA | United States Department of Agriculture |
| UTU | United Transportation Union |
| WCTL | Western Coal Traffic League |
| Wheat & Barley Comm'n | Montana Wheat & Barley Committee, Colorado Wheat Administrative Committee, Idaho Barley Commission, Idaho Wheat Commission, Nebraska Wheat Board, Oklahoma Wheat Commission, South Dakota Wheat Commission, Texas Wheat Producers Board, Washington Wheat Commission, National Association of Wheat Growers |